No. 8888.

# In the United States
# Circuit Court of Appeals
## For the Ninth Circuit.

14

In the Matter of

POMOC OIL COMPANY, a corporation

Debtor.

J. A. SASSO,

*Appellant,*

*vs.*

HERBERT C. GOLDMAN, as Trustee in Bankruptcy of Pomoc Oil Company, a corporation, Debtor,

*Appellee.*

## APPELLEE'S BRIEF.

GEORGE T. GOGGIN,
633 Subway Terminal Bldg., Los Angeles, Cal.,
*Attorney for Appellee.*



Parker & Baird Company, Law Printers, Los Angeles.

## TOPICAL INDEX.

## TABLE OF AUTHORITIES CITED.

### Cases.



### Statutes.



### Textbooks.

No. 8888.

# In the United States
# Circuit Court of Appeals
## For the Ninth Circuit.

---

In the Matter of

POMOC OIL COMPANY, a corporation

Debtor.

---

J. A. SASSO,

*Appellant,*

*vs.*

HERBERT C. GOLDMAN, as Trustee in Bankruptcy of Pomoc Oil Company, a corporation, Debtor,

*Appellee.*

---

## APPELLEE'S BRIEF.

## COUNTER-STATEMENT OF THE CASE AND FACTS.

Appellee, being dissatisfied with the appellant's statement of the case by reason that the same is in certain material respects inadequate and insufficient, submits herewith a counter-statement thereof:

The Pomoc Oil Company, the bankrupt herein, is a family corporation owned exclusively by one George Marcell and his wife. It had acquired a certain oil and gas drilling agreement on 140 acres of land in Kern county,

and had very little, if any, resources. [Tr. 21.] In August of 1936, Marcell, in order to finance the drilling of a well on said property, and to qualify the lease, personally obtained from the appellant herein $2500.00 with the understanding and agreement that the appellant in consideration therefor would receive one-half of the net profits either in the development of the well or in the sale of the lease; the said one-half profits, however, to be one-half of the profits of Marcell. It was agreed that the company would finance the development of the property in the best possible manner, and it was the appellant's understanding that the proposition would be very profitable to him. [Tr. 25.] At the time the sum of $2500.00 was advanced, it was paid by check to Marcell personally. [Tr. 4 and 5.] Marcell and his wife executed their personal notes for the said sum to the appellant. [Tr. 5.] Some time thereafter Marcell had the Pomoc Oil Company also issue its note for said sum [Tr. 6], "because," as appellant states, "the Pomoc Oil Company was owned by George Marcell and Mrs. Marcell." [Tr. 5.] There was an additional sum thereafter advanced by the appellant to Marcell in the amount of $500.00. [Tr. 7.] There appears to be no notes given for this sum. Thereafter the property was developed and the Pomoc Oil Company incurred obligations which have not been paid. [Tr. 21.]

During the development of the property, Marcell had many conversations with the appellant as to what their respective interests would be in the company, together with what their equity might be therein, and at various

times they sat down and figured out what their accounts would be in the enterprise. [Tr. 9.] On March 9, 1937, a *default* judgment was entered in the Superior Court of the state of California, in favor of the appellant against the Pomoc Oil Company for the sum of $2843.00, and an abstract thereof was obtained on the 19th day of March, 1937. On said date, March 19, 1937, the bankruptcy proceedings herein were commenced under section 77-B, which proceedings have terminated in liquidation. [Tr. 21.] Appellant thereafter filed his claim based upon the judgment. The trustee objected to the claim, and at the hearing thereof the referee subordinated the claim to the claims of general creditors. On review, the District Court sustained and confirmed the findings and order of the referee.

## QUESTIONS PRESENTED.

The essence of appellant's propositions of law, followed by argument, appear to be the following:

1. That the default judgment obtained by the appellant but a few days prior to the filing of the bankruptcy proceedings herein so changed the character of the debt of the appellant that the same cannot now be inquired into.

2. That the appellant's claim should be classified and paid in the same manner as the claims of general unsecured creditors.

The appellee contends, however, and submits the following as the questions of law herein:

I.

The incidents of an old debt will be carried forward to determine the character, method, and extent of the allowance of a claim reduced to a judgment when the same is filed in a court of bankruptcy.

II.

The claim of appellant is subordinate and junior in rank to the claims of general creditors who have furnished labor and material at a normal profit.

III.

The claimant was a joint adventurer with the Pomoc Oil Company and others in the bankrupt's enterprise.

IV.

That in matters of bankruptcy the appellate courts will not on appeal reverse the findings of the District Court and the Referee when the same are based upon their conclusions on questions of fact.

## ARGUMENT.

### I.

### The Incidents of an Old Debt Will Be Carried Forward to Determine the Character, Method, and Extent of the Allowance of a Claim Reduced to a Judgment When the Same Is Filed in a Court of Bankruptcy.

It must be remembered that the question arising herein by reason of the subordination of appellant's claim is not as to the validity of the debt, but rather of the order of payment of the same in the bankruptcy proceeding.

We believe the law to be well established that a trustee in bankruptcy not only may but should, as a part of his duty, inquire into a claim based upon a judgment to determine its order of payment. We refer the Court to the learned and scholarly discussion of the subject by the Circuit Court of Appeals for the Eighth Circuit, in the case of *Cutler Hardware v. Hasker,* 238 Fed. 146, wherein the court states:

> "While merger in judgment is a general rule, yet according to recognized exceptions *the judgment will be construed as a new form of the old debt when justice and equity require.* The incident of the old debt will be carried forward to prevent the unequitable destruction of a right, privilege, or exemption."

Here the court cites the fundamental principle underlying the subject, and recites the language of the United States Supreme Court in the case of *Wisconsin v. Pelican Insurance Co.,* 127 U. S. 265, wherein it is said:

"The essential nature and real foundation of a cause of action are not changed by recovering a judgment upon it; and the technical rules which regard the original claim as merged in the judgment, and the judgment as implying a promise to pay it, do not preclude a court, to which a judgment is presented for affirmative action . . . from ascertaining whether the claim is really one of such a nature that the court is authorized to enforce it."

And the Circuit Court thereafter says:

"The doctrine (referring, of course, to the doctrine and principles annunciated by the Supreme Court) applies also to the method and extent of the enforcement in bankruptcy. In *Turner v. Turner,* 108 Fed. 785, the court held that in determining whether a money judgment against a bankrupt was provable against his estate, it would consider the nature of the original cause of action. It said: *'Reducing a debt or duty into judgment works no change in its character, notwithstanding the change in form* from that of a simple debt or duty by merger into a judgment of a court of record, *it still remains the same debt* or duty on which the action was first brought.' "

The court then says:

"It is a very common thing to look into a judgment to see what it was about. . . . It appears that the judgments of appellants were rendered but nine days before the adjudication and that the bankrupts were then insolvent."

The Circuit Court of Appeals for the Seventh Circuit in a similar case to the one herein being considered, stated as follows, in the case of *In re Continental Engine Co.,* 234 Fed. 58:

> "The claim was founded *on a judgment rendered by default in the state court.* The reduction of an alleged debt to a judgment in a state court *before bankruptcy does not exempt it from attack by or on behalf of creditors* who would be injuriously affected by its allowance, when such allowance is sought in bankruptcy proceedings. *Chandler v. Thompson,* 120 Fed. 940."

It will be noted in the case just cited that the claim filed by the judgment creditor was allowed by the lower court, but the Circuit Court considered the matter upon its merits, went behind the judgment and accordingly reversed the lower court with directions to sustain the objections and to disallow the claim. We also refer the Court to the case of *In re Baker,* 96 Fed. 954, at page 959, wherein the court states the law to be as follows:

> 'There is no merit in the contention that because a judgment is, generally speaking, a debt, it is like any other debt in the administration of the bankruptcy law. *The character of the claim upon which the action is brought and the nature of the proceedings enter into and determine the character of the judgment when brought into a court of bankruptcy."*

## II.

### The Claim of Appellant Is Subordinate and Junior in Rank to the Claims of General Creditors Who Furnished Labor and Material at a Normal Profit.

It is an elementary principle of bankruptcy law that the court has the power to adjust the equities existing among general creditors so that those creditors who have been guilty of conduct which, under the ordinary rules of equity, would make it inequitable for them to share in the dividends on an equality with other creditors will be postponed to the claims of other creditors in the distribution of dividends.

See Remington, on Bankruptcy, Vol. 6, page 477, section 2875, and numerous cases therein cited. See, also, the case of *In re Headley,* 97 Fed. 765, wherein the court states the law to be:

> "The bankrupt law is administered upon lines of equity jurisprudence, and as between contending creditors the bankrupt court in the interest of fair dealing and good conscience has the unquestioned power to postpone the claims of such a creditor in favor of other creditors."

It must be remembered that in adjusting the equities of creditors, the general principles of equity jurisprudence rather than state law are controlling.

See *Barks v. Kleyne,* 15 Fed. (2d) 153, C. C. A. 8th:

> "This is not a question of the validity of a debt, but of the order of payment in the bankruptcy proceeding of a concededly valid indebtedness."

It is not necessary that the appellant be a stockholder, a partner, or a joint adventurer to place him after general creditors in the payment of claims.

*In re Hicks-Fuller Co.*, 9 Fed. (2d) 492:

> "They can be creditors as distinguished from stockholders and yet have no right to payment in case of insolvency of the corporation until after general creditors have been paid in full. *The finding of the referee, affirmed by the court, was that the claimants were creditors of the bankrupt corporation, junior in right of payment to general creditors.* . . . It is entirely possible for a creditor, either through the contract giving rise to the indebtedness or *through some other contract affecting his status or governing his rights,* to bind himself to give precedence to ordinary creditors."

The contract of August 5, 1936, between the appellant and Marcell clearly shows that the consideration for the advancement of the sum of money herein claimed was the proceeds to be realized by the appellant either from the operation of the well itself or from a subsequent sale. [Tr. 25.] It is apparent that the parties contemplated that the venture would be very profitable to them. [Tr. 25.] And it was this inducement of profit which encouraged the appellant to participate in the enterprise. [Tr. 26.] In fact, it will be noted that during the drilling of the well and thereafter the appellant and Marcell conferred on many occasions in the appellant's office regarding the division of the spoils. [Tr. 9.] Unfortunately for them, however, the venture was not a success, and accordingly the appellant now attempts to change his position to that of an ordinary creditor in order to participate in the dividends

equally with those creditors who had furnished to the venture labor and materials at merely a normal profit.

In the case of *Bank of America v. Fisher,* in 61 Fed. (2d) 53, this Circuit Court stated the law to be:

> "The courts are less interested in safe-guarding 'extraordinary profits' than they are in enforcing the 'ordinary' claims of general creditors who have furnished labor or material at a normal profit. Such creditors should be preferred over persons who have, in the language of counsel, taken a 'long chance,' that is to say, a 'gambler's change.' *Sound public policy demands that the creditor should have preference over the speculator.*"

From the contract itself it is apparent that had the bankrupt prospered and continued the operation of the oil well, that the appellant would have prospered with Marcell and his wife to an extent that his contract did not even attempt to limit. That is, taking the contract at its face value, the appellant would have a one-fourth interest in the venture.

We contend, therefore, that the appellant must likewise be prepared to share in the bankrupt's misfortune. There is no equity in favor of the appellant that places him in a position equal to that of the general creditors who furnished merchandise or labor at only a normal profit. He should be only too willing and ready to take the bitter with the sweet. For these reasons, among others, the referee and the district judge concluded that the claim of appellant is subordinate to the payment of the claims of general creditors.

## III.

### The Appellant Was a Joint Adventurer With Marcell and the Pomoc Oil Company in the Enterprise.

The appellant in his brief contends that because Marcell conveyed to him one-half of Marcell's interest in the company, that therefore he, the appellant, is absolved from being classified as a co-adventurer. The record shows that the drilling of the well was clearly Marcell's enterprise. In his agreement with the appellant it is therein stated: "*It is necessary for me* to start rigging up at once and ask that you accept this letter immediately if the transaction is satisfactory to you." [Tr. 7.] The transaction was indeed satisfactory to the appellant for he paid by check to Marcell personally and not to the Pomoc Oil Company, the money involved herein and obtained in addition to his interest in the venture, personal notes of Marcell and his wife. [Tr. 4.] It is true that some time thereafter the appellant did obtain from Marcell notes of the Pomoc Oil Company, but it will be noted that at that time the appellant and Marcell were well launched on their venture of drilling this oil well. The Federal Courts have repeatedly held that in cases of bankruptcy, they will not hesitate to look through the shell of corporate identity to get at the real purpose of association of individuals.

See *Finch Co. v. Robie,* 12 Fed. (2d) 360, C. C. A. 8, and numerous cases therein digested. The court in that case quotes with approval the following:

> "We have of late refused to be always and utterly trammelled by the logic derived from corporate existence where it only serves to distort or hide the truth."

The appellant attempts to use the language in two California cases to absolve himself from being considered a joint adventurer. The first is *Spier v. Lang,* 4 Cal. (2d) 711; suffice it to say that the Supreme Court in this case held that (quoting from page 716, line 7):

> "The question whether a partnership or the relation of joint adventure was created is primarily a question for the trial court to determine from the facts and the inferences to be drawn therefrom."

This we concede to be the law, and inasmuch as the trial court in that case did hold that the relation of joint adventure was not created, the Supreme Court accordingly affirmed the trial court's decision.

The second case cited by the appellant is *Treat v. Murdock,* 8 Cal. (2d) 316. It will be noted in this case that the provisions of the contract clearly show that the transaction was nothing more nor less than a loan and that the appellants in that case never acquired or contracted to secure any title to the property or any interest in it. It will be noted thereafter, in analyzing the case, that the court states the law to be that although the partners must actually engage in working the mine, it does not mean, however, that each of the partners must perform physical labor in the mine, but that it does mean that each of the partners have some part in carrying on the mining operations. This case is clearly not in point by reason of the fact that there is no agreement in existence such as we have in the instant case. In construing whether a mining co-partnership exists or whether the relationship is that

of a joint adventurer, we must be governed by the established law as set forth by the Supreme Court of this state in the following case:

*Harper v. Sloan,* 177 Cal. 174, at p. 181, wherein it is stated:

> "If it is said that there was to be no partnership until the defendants had become the owner of two-thirds of the claim, the results would not be different. It is alleged that the defendants paid $7,000.00, which constituted the full consideration for their acquisition of two-thirds . . . upon the payment, . . . Dwyer and Sloan became the equitable owners of two-thirds of the property and *such equitable ownership was a sufficient basis for the existence of a partnership.* . . . The contract between the parties provides that the $7,000.00 to be paid by the defendants *is to be used in the development and working of the claim.* We do not understand that it is essential to a mining partnership that each of the partners shall actually perform physical work upon the claim. *Where one of them supplies money which is to be used in working the claim, he is engaged in such work as truly as is the one who devotes his own labor to the enterprise.*"

We also refer the court to the case of *Stern v. Ulrich,* 10 Fed. (2d) 8, C. C. A. 8, wherein it is said:

> "Where they join their efforts or property in development of the mining property that constitutes a mining co-partnership. . . . Mining partnerships

> are held generally to be applicable to development of oil and gas properties. . . . Such partnership may result from express contracts *or be implied by the conduct of the parties* in joining in mining operations on a profit and loss sharing basis. . . ."

The court thereafter states that:

> "There is nothing in the nature of a corporate organization as such which would prevent it from being a member of a mining partnership or in a joint adventure of that character."

We also refer the court to section 2512 of the Civil Code of the state of California, which reads as follows:

> *"An express agreement to become partners or to share in the profits and losses of mining is not necessary to the formation or existence of a mining partnership. . . ."*

By analogy, other cases that are in point and that sustain this general principle of law are the following:

*Duryea v. Burt,* 28 Cal. 569;

*McIntosh v. Perkins,* 32 Pac. 653;

*Perkins v. Peterson,* 29 Pac. 1135;

*Nowell v. Oswald,* 96 Cal. App. 537;

*Associated Piping and Engineering Co. v. Jones,* 17 Cal. App. (2d) 107.

## IV.

### In Matters of Bankruptcy the Appellate Courts Will Not on Appeal Reverse the Findings of the District Court and the Referee When the Same Are Based Upon Their Conclusions on Questions of Fact.

The sole question before the referee and the district judge by reason of the objection to the appellant's claim might be construed to be the following: Is the appellant's claim of such a nature as to warrant the postponing of the payment thereof to the payment of claims of general creditors, and is the appellant under the particular circumstances of this case a co-adventurer? Truly, the question presented must be determined by the trial court from the facts and the inferences to be drawn therefrom.

It is stated by the Supreme Court of the state of California in a similar case where the same question was involved, and which case has heretofore been cited by the appellant, *Spier v. Lang,* 4 Cal. (2d) 711, at 716, that:

> *"The question whether* a partnership or the relation of *joint adventure was created was primarily a question for the trial court to determine* from *the facts and the inferences to be drawn therefrom."*

This court recently in the case of *Ott v. Thurston,* 76 Fed. (2d) 368, quoted from O'Brien's Manual of Federal Appellate Procedure, as follows:

> "The court of appeals for the ninth circuit quotes with approval the language of Remington on Bankruptcy, foot note to Section 3871, 4th Edition, Vol-

ume 8, page 227, 'and it is especially true that the reviewing courts will not disturb findings of fact except for manifest error where both the referee and the district judge have coincided.' "

O'Brien in his Manual refers to the following cases:

*Neece v. Durst,* 61 Fed. (2d) 591, C. C. A. 9;

*Woods v. Naimye,* 69 Fed. (2d) 892, C. C. A. 9;

*Swift v. Higgins,* 72 Fed. (2d) 791, C. C. A. 9;

and also

*Sliman v. Lane,* 84 Fed. (2d) 553, C. C. A. 8.

The Circuit Court of Appeals for the seventh circuit, in the case of *In re Feldham,* 86 Fed. (2d) 495, states:

> "It is scarcely necessary for this court to again assert that it does not try questions of fact and will not on appeal disturb the lower court's findings of fact *where there is substantial and competent evidence to support the same.*"

Also see the case of *Watchmaker v. Barnes,* 259 Fed. 783, C. C. A. 1, wherein the court states the law to be as follows:

> "His findings *cannot be reversed unless they are* clearly wrong because *not sustained by any fact or evidence or inference* which might reasonably be drawn therefrom."

We respectfully submit that the referee and the district judge carefully considered the facts and the circumstances surrounding the appellant's dealing with Marcell

and the bankrupt and they consequently inferred therefrom that to permit the appellant to participate in the payment of dividends equally with creditors who furnished labor and material would be inequitable, unconscionable, unjust, and legally unwarranted.

We respectfully submit, therefore, that the order of the referee, confirmed by the district court, be affirmed by this Honorable Court.

Respectfully submitted,

GEORGE T. GOGGIN,

*Attorney for Appellee.*

(Note: All italics in the brief herein are ours.)